development.

16. Subsequent Events

In January 2020, the Company entered into two promissory notes totaling $500,000 payable in full on the ninth month anniversary. These notes bear an interest rate of 1 percent per month and Payee will receive 50,000 warrants at 0.85 cents strike price with a duration of five years.

In January 2020, the Company entered into two promissory notes totaling $500,000 payable in full on the sixth month anniversary. This note bears an interest rate of 1 percent per month and Payee will receive 50,000 warrants at 0.85 cents strike price with a duration of five years.

Effective January 2019, the Company entered into a one-year Board Member agreement, and as part of that agreement for services agreed to issue 250,000 shares of the Company's common stock and 250,000 options priced at $1.00.

On January 7, 2020, the Company, completed a joint venture with Community Growth Partners, Inc. ("CGP"), a vertically-integrated cannabis company with provisional licensed operations in Massachusetts. The Massachusetts Cannabis Control Commission recently awarded CGP three provisional cannabis licenses for cultivation, manufacturing and retail – making CGP one of the Commonwealth's first women- and minority-founded and owned businesses to become approved as a vertically-integrated cannabis operation. Stem will acquire 49% of CGP's common stock and will then provide a $2 million revolving line of credit for future expansion into Massachusetts. The agreements are subject to approval of the Massachusetts Cannabis Control Commission and other local state authorities.

In March 2020, the Company entered into a six-month consulting agreement, and as part of that agreement for professional services, agreed to issue a total of 350,000 shares of the Company's common stock and $100,000 cash compensation. Pursuant to the agreement, all 350,000 shares of common stock will be restricted securities.

In March 2020, the Company executed a $1,585,000 mortgage payable on property located in Oregon to acquire additional funds. The mortgage bears interest at 11.55% per annum. Monthly interest only payments began April 1, 2020 and continue each month thereafter until paid. The entire unpaid balance is due on April 1, 2023, the maturity date of the mortgage, and is secured by the underlying property. The Company paid costs of approximately $120,000 to close on the mortgage. The mortgage terms do not allow participation by the lender in either the appreciation in the fair value of the mortgaged real estate project or the results of operations of the mortgaged real estate project. The note has been cross guaranteed by the CEO and Director of the Company.

In March 2020, the Company acquired Seven Leaf Ventures Corp. ("7LV"), a private Alberta corporation, and its subsidiaries, pursuant to the terms of a share purchase agreement dated March 6, 2020. 7LV owns Foothills Health and Wellness, a medical dispensary, in the greater Sacramento, California area. In connection with the acquisition, the Company issued 11,999,008 shares of common stock to former shareholders of 7LV ("7LV Shares"). The Company issued an aggregate 682,000 shares and replacement 10% unsecured convertible debentures in the aggregate principal amount of C$3,410,000 (the "Replacement Debentures"), convertible into shares at a conversion price of C$1.67 per share at any time prior to May 3, 2021, to former holders of unsecured convertible debentures of 7LV. As part of the Acquisition, the Company assumed the obligations of 7LV with respect to the common share purchase warrants of 7LV outstanding on the closing of the acquisition, subject to appropriate adjustments to reflect the exchange ratio. Accordingly, the Company has assumed 1,022,915 common share purchase warrants (the "Warrants"), exercisable into shares at an exercise price of C$2.08 per share at any time prior to May 3, 2021, 299,975 Warrants, exercisable into shares at an exercise price of C$4.17 per share at any time prior to December 31, 2020 and 999,923 Warrants, exercisable into shares at an exercise price of C$0.50 at any time prior to October 10, 2020. Following the completion of the acquisition, 7LV is now a wholly-owned subsidiary of the Company. Certain shareholders of 7LV, who collectively held approximately 74.5% of the 7LV Shares outstanding at the closing of the acquisition, have agreed to a contractual lock-up pursuant to which such shareholders will not transfer 25% of the Company's shares received as part of the acquisition until approximately 90 days following the acquisition by 7LV of the Sacramento California Dispensary.

In March 2020, the Company's Board of Directors elected to propose to the holders of the Canaccord 8% convertible debentures and warrants a reduction in their conversion and exercise prices, respectively. The Company has proposed to reduce the conversion price for each convertible debentures to CDN 1.50 ($1.04 based on March 19, 2020 spot forex from CAD to USD) and to reduce the exercise price of the warrants to CDN 1.15 ($0.79 based on March 19, 2020 spot forex from CAD to USD). In accordance with the requirements under the convertible notes and warrants, the Company will hold a special meeting on April 7, 2020 in which the holders will be able to participate and vote on the changes noted above.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Forward Looking Statements

This Interim Report on Form 10-Q contains, in addition to historical information, certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 ("PLSRA"), Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act") regarding Stem Holdings, Inc. (the "Company" or "Stem", also referred to as "us", "we" or "our"). Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historical or current facts. Forward-looking statements involve risks and uncertainties. Forward-looking statements include statements regarding, among other things, (a) our projected sales, profitability, and cash flows, (b) our growth strategies, (c) anticipated trends in our industries, (d) our future financing plans and (e) our anticipated needs for working capital. They are generally identifiable by use of the words "may," "will," "should," "anticipate," "estimate," "plans," "potential," "projects," "continuing," "ongoing," "expects," "management believes," "we believe," "we intend" or the negative of these words or other variations on these words or comparable terminology. These statements may be found under "Management's Discussion and Analysis of Financial Condition and Results of

Operations" and "Description of Business," as well as in this Form 10-Q generally. In particular, these include statements relating to future actions, prospective products or product approvals, future performance or results of current and anticipated products, sales efforts, expenses, the outcome of contingencies such as legal proceedings, and financial results.

Any or all of our forward-looking statements in this report may turn out to be inaccurate. They can be affected by inaccurate assumptions we might make or by known or unknown risks or uncertainties. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially as a result of various factors, including, without limitation, the risks outlined under "Risk Factors" detailed in the Company's Form 10 registration statement, 10k annual report and matters described in this Form 10-Q generally. In light of these risks and uncertainties, there can be no assurance that the forward-looking statements contained in this filing will in fact occur. You should not place undue reliance on these forward-looking statements. The forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, we undertake no obligation to publicly update any forward-looking statements, whether as the result of new information, future events, or otherwise. We intend that all forward-looking statements be subject to the safe harbor provisions of the PSLRA.

For the three months ended December 31, 2019, the financial statements have been prepared by management in accordance with the standards of the Public Company Accounting Oversight Board (United States). For the three months ended December 31, 2019 and 2018, the unaudited interim financial statements have been prepared by management in accordance with the condensing rules of the United States Securities and Exchange Commission.

Results of Operations

The operations of the Company have changed dramatically over the past year and therefore the results presented herein in this management's discussion and analysis are not directly comparable. For the three months ended December 31, 2018, our results are only for Stem Holdings, Inc. and they comprise only real estate rental and general and administrative operations. At this time, the results of operations and financial position for the variable interest entities and affiliates we consolidated at our 2019 fiscal year end and ongoing into the 1st quarter of fiscal 2020, were immaterial and therefore not included in the three months ended December 31, 2018. In the three months ended December 31, 2019, none of our results encompass real estate rental operations. The entirety of our operations now result directly from our cultivation, production and sale operations for cannabis and related products. In addition, we have in this period expanded beyond the state of Oregon, and in the three months ended December 31, 2019, our results include operations in the state of Oregon, California, and Nevada.

	For the Three Months Ended December 31,	
($ in thousands)	**2019**	**2018**
Revenue	$ 1,321	$ 338
Net (loss)	(3,312)	(4,167)
Basic and diluted earnings (loss) per share	(0.06)	(0.30)

Comparison of the results of operations for the three months ended December 31, 2019 compared to the three months ended December 31, 2018

The Company had revenues during the three months ended December 31, 2019 of $1,321 compared with $338 for the comparable period of 2018, the increase in revenue was primarily related to the acquisition Yerba and the consolidation of four related entities.

Cost of goods for the three months ended December 31, 2019 amounted to approximately $1,069 compared to $0 in the comparable period of the prior year. These costs include both the cost of finished product purchased for retail and the cost of cultivation and processing for the grow facilities and sold at the wholesale level.

In the three months ended December 31, 2019, we incurred consulting costs of approximately $509 compared to approximately $1,103 in the comparable period of the prior year. The decrease in consulting fees was attributed to a reduction of stock based expenses for consultants. We expended those fees as we have yet to build up a significant employee base and currently outsource certain tasks to consultants. We expect in the upcoming year to increase our consulting fees as we continue to grow, even though we do expect to increase staffing, as we do not expect that growth will be commensurate with our growth from operations in the near term.

In the three months ended December 31, 2019, we incurred professional fees of approximately $639 compared to approximately $442 in the comparable period of the prior year. Those fees are primarily for legal, accounting and related services that pertains to our being a public company in both the United States and Canada. We expect as we grow our operations these costs will continue to grow.

In the three months ended December 31, 2019, we incurred general and administrative costs of approximately $1,990 compared to approximately $1,578. This increase relates primarily to an increase costs related to the inclusion of certain entities due to their being variable interest entities plus the acquisition of the assets, liabilities and operations of Yerba Oregon, LLC in June 2019.

LIQUIDITY AND FINANCIAL CONDITION

Liquidity and Capital Resources

The Company had cash of approximately $671 as of December 31, 2019. Our primary uses of cash have been for salaries, fees paid to third parties for professional services, insurance, general and administrative expenses, investment in entities engaged in the cultivation, production and sale of cannabis and related rental properties for those entities and the acquisitions and development of rental properties and their improvement. All funds received have been expended in the furtherance of growing the business. We have received funds from financing activities such as from equity offerings and debt financing as well as the proceeds from the acquisition of entities with significant cash holdings. The following trends are reasonably likely to result in changes in our liquidity over the near to long term:

- An increase in working capital requirements to finance our continued development of our cultivation, production and sale of cannabis:
- Acquisition and buildout of rental properties;
- Addition of administrative and sales personnel as the business grows and
- The cost of being a public company.

Subsequent to December 31, 2019, we have raised an additional $1 million in funds from the issuance of promissory notes in our private placements. Our efforts to raise additional capital are ongoing and we expect to continue our efforts in the following quarters.

With respect to the company's investments in the projects pertaining to the equity method investee's and affiliates, we have committed that we need to spend an estimated $2.5 million in expansion, buildout and improvements potentially in the near term. These capital expenditures are contingent upon several factors including the Company obtaining financing for the development of the properties and the construction of the tenant improvements in such amount and on such terms and provisions as are acceptable to the Company.

The Company has entered into a joint venture in which the Company has extended a $2.5 million line of credit for Community Growth Partners Holdings, Inc. ("CGP"). The Company is obligated to fund at the request of CGP. The Company does not currently have the funds available to fund the entire commitment. The line of credit requires no repayment until each of two separate retail stores are opened and six months of operations occur. If neither store opens, then no amounts are repayable, which may happen.

As of December 23, 2019 has entered into a stock purchase agreement with Attollo Capital Holdings A, LLC (the "Purchaser") pursuant to which Stem will issue 11,764,706 shares of preferred stock of the Company (the "Preferred Stock") at a purchase price of US$0.85 per share of Preferred Stock (the "Original Issue Price") for gross proceeds to the Company of approximately US$10,000,000 (the "Investment"). As of the date of this filing, the Company has not yet closed on this transaction.

We have used our available funds to fund our operating expenses, pay our obligations, acquire and develop rental properties, and grow our company. We need to raise significant additional capital or debt financing to acquire new properties, to develop existing properties, and to assure we have sufficient working capital for our ongoing operations and debt obligations. There is no guarantee that such funding will be available to the Company at a viable cost, if at all.

Cash Flow

For the three months ended December 31, 2019 and 2018

Net cash flows used in operating activities was approximately $1,755 for the three months ended December 31,2019 as compared net cash flow used in operating activities to approximately $635 for the three months ended December 31, 2018, a change of approximately $1,120.

- Net cash flow used in operating activities for the three months ended December 31, 2019 primarily reflected a net loss before losses of equity method investees of approximately $3,312 adjusted for the add-back of non-cash items consisting of depreciation and amortization of approximately $500, stock-based compensation expense of approximately $497, non-cash interest of approximately $37, amortization of debt discount of $253, and foreign currency translation adjustment of $69 offset by a change operating assets and liabilities consisting of an increase in accounts receivable of approximately $7, an increase in prepaid expenses and other current assets of $69, a decrease in other assets of $500 and net changes in other operating liabilities of approximately $268.

- Net cash flow used in investing activities for the three months ended December 31, 2019 amounted to approximately $783 as compared to approximately $803 for the three months ended December 31, 2018. Net cash flow used in investing activities for the three months ended December 31, 2019 consisted of approximately $321 used in the development of leased properties including the expansion of rentable space, upgrading irrigation, ventilation, plumbing and electrical systems, and the purchase of property and equipment. The Company advanced $462 to related entities in the period.

- Net cash used in financing activities was approximately $130 for the three months ended December 31, 2019 as compared to net cash provided by financing activities of approximately $4,471 for the three months ended December 31, 2018. During the three months ended December 31, 2019, we made payments on several equipment and insurance obligations.

CRITICAL ACCOUNTING POLICIES

Basis of preparation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The condensed financial statements included herein are unaudited. Such financial statements, in the opinion of management, contain all adjustments necessary to present fairly the financial position and results of operations as of and for the periods indicated. All such adjustments are of a normal recurring nature. These interim results are not necessarily indicative of the results to be expected for the year ending September 30, 2020 or for any other period. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission, and because of this, for further information, readers should refer to the financial statements and footnotes included in our Form 10-K for the fiscal year ended September 30, 2019 filed with the Securities and Exchange Commission on March 2, 2020. The Company believes that the disclosures are adequate to make the interim information presented not misleading.

Principals of Consolidation

The accompanying condensed consolidated financial statements include the accounts of Stem Holdings, Inc. and its wholly-owned or controlled operating subsidiaries, Stem Holdings Oregon, Inc., Stem Holdings IP, Inc., Opco, LLC, Stem Agri, LLC., Stem Group Oklahoma, Inc. and Stem Holdings Florida, Inc. All material intercompany accounts, transactions, and profits have been eliminated in consolidation.

Use of estimates

The preparation of these financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Estimates and judgments used are based on management's experience and the assumptions used are believed to be reasonable given the circumstances that exist at the time the financial statements are prepared. The significant estimates included in these financial statements are those associated with the assumptions used to value equity instruments, valuation of its properties for impairment testing and the deferral of rents. Actual results may differ from these estimates.

Revenue recognition

The Company recognizes revenue when its customer obtains control of promised goods or services, in an amount that reflects the consideration which the entity expects to receive in exchange for those goods or services. To determine revenue recognition for arrangements that an entity determines are within the scope of Accounting Standards Codification (ASC) Topic 606, Revenue from Contracts with Customers (Topic 606), the entity performs the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the entity satisfies a performance obligation. The Company only applies the five-step model to contracts when it is probable that the entity will collect the consideration it is entitled to in exchange for the goods or services it transfers to the customer. At contract inception, once the contract is determined to be within the scope of Topic 606, the Company assesses the goods or services promised within each contract and determines those that are performance obligations and assesses whether each promised good or service is distinct. The Company then recognizes as revenue the amount of the transaction price that is allocated to the respective performance obligation when (or as) the performance obligation is satisfied.

Revenue for the Company's product sales has not been adjusted for the effects of a financing component as the Company expects, at contract inception, that the period between when the Company's transfers control of the product and when the Company receives payment will be one year or less. Product shipping and handling costs are included in cost of product sales.

CONTRACTUAL OBLIGATIONS AND COMMITMENTS

As noted earlier in Note 1, the Company, engages in a business that constitutes an illegal act under the laws of the United States Federal Government. This raises several possible issues which may impact the Company's overall operations, not the least of which are related to traditional banking and other key operational risks. Since cannabis remains illegal on the federal level, and most traditional banks are federally insured, those financial institutions will not service cannabis businesses. In states where medical or recreational marijuana is legal, dispensary owners, manufacturers, and anybody who "touches the plant," continue to face a host of operational hurdles. While local, state-chartered banks and credit unions now accept cannabis commerce, there remains a reluctance by traditional banks to do business with them. Aside from a huge inconvenience and the need to find creative ways to manage financial flow, payroll logistics, and payment of taxes, this also poses tremendous risks to controls as a result of operating a lucrative business in cash. This lack of access to traditional banking may inhibit industry growth. In the period ended December 31, 2019, the Company's accounts with a major money center bank were closed as the bank would not allow the Company to continue to use its banking network.

Despite the uncertainties surrounding the Federal government's position on legalized marijuana, the Company does not believe these risks will have a substantive impact on its planned operations in the near term.

As of December 31, 2019, the Company has acquired interests in several entities. As part of those interests, the Company has commitments to fund the acquisition of licenses and permits to allow for the cultivation and sale of cannabis and related products in the United States and Eswatini. As of December 31, 2019, Company estimates that its investees will need up to approximately $2.5 million to complete the acquisition of licenses and permits, to fund the buildout or expansion of facilities to fully operate in their respective cannabis markets, which will encompass several years of development.

OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any off-balance sheet arrangements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES